Articles

The proper role of shareholders in the decision-making processes of modern large Australian public companies

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Calls for increased shareholder intervention in the routine business operations of large Australian public companies should be reconsidered. Constant shareholder involvement in matters concerning the management of a company's routine business affairs is likely to cause several intractable problems. Most shareholders do not have the information or skills necessary to make sound decisions on either operational or policy issues. In any event, given that they are a collection of individuals and groups of people with different, and often, irreconcilable interests, shareholder opinions are bound to differ as to which course will best serve the interest of a company. Increased shareholder intervention in operational issues thus poses the threat of a decline in the quality of corporate decision-making. For these reasons, the management of the business affairs of large, complex companies should continue to be the primary responsibility of boards of directors. Directors are, more often than not, better informed about the long-term prospects and value of a company. Therefore, in order to maximise the value of public companies, shareholder participation in decision-making should continue to occur in limited circumstances, as a means of promoting the accountability of directors.

1 Introduction

One of the defining features of the modern large public company is, as is now very well known, the separation of the functions of ownership and control. More often than not, the powers of direction over the business of a public company are wielded, not by its owners, the shareholders, but by directors who in most cases do not own any meaningful part of its capital. The factors leading to this development, and its effects, were most ably articulated by US scholars Adolph Berle and Gardiner Means in their seminal work, *The Modern Corporation and Private Property*, published in 1932. Of particular interest, in that study Berle and Means observed that one of the practical and most disconcerting consequences of divorcing ownership from control was to

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release the management of a public company from the overriding requirement that they serve its stockholders.[1] They opined that:

> the concentration of economic power separate from ownership has, in fact, created economic empires, and has delivered these empires into the hands of a new despotism, relegating the new owners to the position of those who supply the means whereby the new princes may exercise their power.[2]

The fear expressed by Berle and Means regarding the potential for directors of public companies to act in disregard of their obligations, with inevitable adverse consequences for shareholders, has actually come to pass in Australia. In the recent past, several cases of serious dereliction of duty[3] on the part of the controllers of certain public companies have occurred, leading to spectacular corporate collapses.[4] As a result of these failures and associated problems, the issue of corporate control has, once again, become a subject of intense interest and debate in Australia. Having regard to the catastrophic consequences these collapses have had on the community,[5] some animated calls have been made for shareholders to engage more closely with, and play a more active role in, the governance of public companies as a means of enhancing the accountability of directors.[6] Elsewhere, some scholars have gone even further and suggested that it is not sufficient to merely ensure that members of public companies are vigilant as monitors of management performance. In order to promote shareholder welfare more fully, they argue, it is imperative that reforms are implemented to enable shareholders to intervene more readily in the day to day operations of public companies. According to the proponents of this view, the governance arrangements of public companies should be designed so that shareholders have authority to

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1 A A Berle and G C Means, *The Modern Corporation and Private Property*, rev ed, Transaction Publishers, New Brunswick; London, 1991, pp 112–16.

2 Ibid, p 116.

3 Indeed, describing the conduct of the directors in the Westpoint saga, Justice French, then of the Federal Court of Australia, said:

> the evidence placed before the Court . . . was extensive and detailed and was not the subject of any substantial challenge. It is indicative of serious misconduct in the affairs of the companies . . . Indeed there are aspects of the evidence suggestive of a ruthless disregard by the Westpoint groups' controllers of the interests of investors and other creditors . . . Other aspects of the evidence . . . are indicative of a degree of carelessness and indifference on their part to their duties as directors.

See *ASIC, Re Richstar Enterprises Pty Ltd (ACN 099 071 968) v Carey (No 3)* (2006) 57 ACSR 307; 24 ACLC 581 at 583–4; [2006] FCA 433; BC200602423.

4 More memorable amongst these are the failures of Storm Financial, Opes Prime, Westpoint, Ansett, HIH, One. Tel and Harris Scarfe.

5 On this, see, eg, the comments of Justice Owen regarding the effects of the collapse of HIH. His Honour sadly lamented that the conduct of the directors of HIH produced a calamity of monumental proportions. See Commonwealth of Australia, *HIH Final Report, Vol 1, A Corporate Collapse and its Lessons*, 2003, at <http://www.hihroyal com.gov.au/finalreport/Front%20Matter,%20critical%20assessment%20and%20summary. HTML#_ Toc37086537>, p 10 (accessed 29 May 2009).

6 See, eg, S Conroy, 'Labor's Approach to Corporate Governance — Empowering the Shareholder' (2003) 15 *The Sydney Papers* 26; M Rawling, 'Australian Trade Unions as Shareholder Activists: The Rocky Path Towards Corporate Democracy' (2006) 28 *SydLRev* 226. For a comment on these pleas, see also S Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance*, Ashgate Publishing Co, Hampshire, England; Burlington, 2007, p 91.

pass binding resolutions at any time requiring directors to take specific actions or enter into particular transactions. Strengthening shareholder power in this manner, it is contended, is likely to boost management discipline.[7] As well, it is suggested that the prospect of shareholder intervention might strengthen the protection of the interests of other stakeholders such as employees, creditors and the community generally.[8]

It is beyond doubt that to the extent it assists to promote the accountability of directors and senior management teams, active shareholder participation in the governance of public companies is beneficial. As has been highlighted by several commentators, accountability and the prospect of replacement put pressure on directors to adopt policies in the interests of investors.[9] This serves to ensure that 'controllers of public companies will act to maximise shareholder welfare. Further, by ensuring that directors answer properly for the use of their powers and comply with certain standards, accountability also promotes legitimacy of corporate decision-making.'[10] For these reasons, a certain level of shareholder involvement in the running of public companies is desirable and so should be encouraged.

Nonetheless, this article argues that while seeking to promote greater shareholder participation in the management of the affairs of public companies, the law should continue to reserve primary responsibility for the day to day management of the business of large, complex public companies to their boards of directors and senior management teams. As this study will endeavour to show, shareholder intervention in specific or routine business decisions, as advocated by some commentators, is likely to cause some intractable problems.[11] To avoid this difficulty, shareholder participation in the decision-making processes of large, public companies should continue be used principally as an accountability measure of last resort.

The ensuing analysis is organised as follows. Part 2 provides an overview of the roles assigned by current corporate law to the board of directors and the general meeting of shareholders, respectively, in the governance of the modern Australian large public company. The analysis here demonstrates that under the present legal framework, the ability of shareholders to participate in the making of routine business decisions is quite restricted. Having established this, the Part goes on to argue that, from an efficiency perspective, the current legal regime has a lot to commend it. Next, Part 3 considers some recent cases in which certain shareholder groups have intervened in the

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7 Conroy, above n 6, at 27–8.

8 See, eg, L A Bebchuk, 'The Case for Increasing Shareholder Power' (2005) 118 *Harvard L Rev* 833; J McConvill, 'Shareholder Empowerment as an End in Itself: a New Perspective on Allocation of Power in the Modern Corporation' (2007) 33 *Ohio Northern Univ L Rev* 1013.

9 By way of example, see Bottomley, above n 6, pp 78–80; J Hill, 'Visions and Revisions of the Shareholder' (2000) 48 *American Jnl of Comparative* Law 40 at 62; F H Easterbrook and D R Fischel, 'Voting in Corporate Law' (1983) 26 *Jnl of Law and Economics* 395 at 407; M M Harner, 'Corporate Control and the Need for Meaningful Board Accountability' *Minnesota L Rev* (forthcoming article), submission, at SSRN <http://ssrn.com/abstract=1393883>, p 12 (accessed 12 June 2009).

10 Hill, above n 9, at 77; Easterbrook and Fischel, above n 9, at 396; Bottomley, above n 6, p 15.

11 This matter is explored in more detail in Part 3.2 below.

management of public companies in an attempt to dictate corporate policy and action. It also examines some of the arguments put forward for reforming the law to facilitate readier shareholder involvement in the management of public companies. Following this, it is argued that while the idea of active shareholder participation in corporate decision-making enjoys support in some quarters, policy makers would be well advised to exercise some restraint in sanctioning any further development of this phenomenon. A legal regime that promotes routine shareholder intervention in the business operations of public companies is more likely to harm than promote shareholder and social welfare. Part 4 concludes the discussion.

2 Decision-making in modern large Australian public companies: The current state of play

2.1 The board of directors as the ultimate decision-maker

It is common practice in Australia today to endow the directors of large, complex public companies with extensive discretion. This course of action, it is believed, offers the most practical option for the effective and efficient management of public companies.[12] Significantly, the Corporations Act 2001 (Cth) promotes this model of corporate management. The default rule provided by the Act concerning the management of the affairs of a company states that:

> (1) The business of a company is to be managed by or under the direction of the directors.
> (2) The directors may exercise all the powers of the company except any powers that this Act or the company's constitution (if any) requires the company to exercise in general meeting.[13]

According to judicial opinion of very high order, where a company adopts this or a similar rule, the power thereby conferred on directors to manage the affairs of a company is complete and exclusive. Under such a regime, shareholders are precluded from interfering with the management of a company.[14] Subject to the over-arching requirements that they act honestly[15]

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12 See, eg, The Parliament of the Commonwealth of Australia, Parliamentary Joint Statutory Committee on Corporations and Securities, *Better Shareholders — Better Company: Shareholder Engagement and Participation in Australia*, June 2008, at <http://www.aph.gov.au/senate/committee/corporations_ctte/sharehold/report/report.pdf>, para 2.2 (accessed 3 June 2009).

13 See Corporations Act s 198A. This is a replaceable rule.

14 See further R P Austin and I M Ramsay, *Ford's Principles of Corporations Law*, 13th ed, LexisNexis Butterworths, Sydney, 2007, para 7.120 (p 227); Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 2.3.

15 Corporations Act s 181(1) imposes on directors a duty to exercise their powers and discharge their duties in good faith in the best interests of the company and for a proper purpose. This is in addition to the duty of honesty and loyalty to the company imposed upon directors by the equitable doctrines of fiduciary law.

On the obligations thus imposed on directors, see, eg, *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656; *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199 at 217; 30 ALR 53; BC2300005; *In re Smith & Fawcett Ltd* [1942] Ch 304 at 306; [1942] 1 All ER 542; *Pergamon Press Ltd v Maxwell* [1970] 2 All ER 809 at 813; [1970] 1 WLR 1167; *Greenhalgh v Ardene Cinemas Ltd* [1951] Ch 286 at 291; [1950] 2 All ER 1120 and with reasonable diligence and care,[16] only the directors may competently make decisions on matters relating to corporate management. This was settled as early as 1906 by the English Court of Appeal in the well-known case of *Automatic Self Cleansing Filter Syndicate Company v Cuninghame*.[17]

It will be recalled that one of the articles of association of the Automatic company vested all powers to manage its business in the board of directors, subject to such regulations as might be made from time to time by shareholders by extraordinary resolution. At a meeting of the company, an ordinary resolution was passed by a simple majority of shareholders whereby it was purported to sell certain assets of the company to another firm set up for the specific purpose of acquiring the property in issue. The board of directors refused to give effect to that resolution. In the opinion of the directors, it was not in the interest of the company for it to sell its property on the terms agreed upon. An action was commenced by some shareholders seeking an order to compel the directors to affix the company's seal to the resolution passed, and so carry into effect the contract of sale approved by the shareholders.

When the matter came before it, the Court of Appeal elucidated that the articles of association of a company constitute a contract. That being the case, by adopting the relevant regulation, the shareholders had in this case 'contracted' away their power to manage the company.[18] That power was now constitutionally vested in the directors.[19] As such, the court went on to expound, the directors could ignore the resolution passed and, consequently, the wishes of the majority. This position was re-affirmed by the Court of Appeal in another much celebrated case, *John Shaw & Sons (Salford) Ltd v Shaw*.[20] To remove any lingering doubt regarding the respective roles of the general meeting of shareholders and the board of directors where the constitution of a company vests the management function in the latter, the court emphatically declared that:

> if powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to

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at 1126; *Mills v Mills* (1938) 60 CLR 150 at 185; 11 ALJR 527; *Hindle v John Cotton Ltd* (1919) 56 Sc LR 625 at 630; *Thorby v Goldberg* (1964) 112 CLR 597; BC6400700; *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1; 3 ACLR 176; 52 ALJR 399; (1977-78) CLC 40-389; *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; 5 ALR 231; 49 ALJR 74; BC7500014; *Furs Ltd v Tomkies* (1936) 54 CLR 583; 9 ALJR 419; BC3600050; *Boardman v Phipps* [1967] 2 AC 46; [1966] 3 All ER 721; [1966] 3 WLR 1009; *Bray v Ford* [1896] AC 44; *Aberdeen Railway Co v Blaikie Brothers* (1854) 2 Eq Rep 1281; 1 Macq 461; [1843-60] All ER Rep 249.

16 Corporations Act s 180(1). This statutory obligation is supplementary to the directors' common law duty of skill, care and diligence. As to the dictates of this duty reference may be made to *ASIC v Adler* (2002) 41 ACSR 72; 20 ACLC 576; [2002] NSWSC 171; BC200200827; *In re City Equitable Fire Insurance Company Ltd* [1925] Ch 407; [1924] All ER Rep 485; *Re Brazilian Rubber Plantations & Estates Ltd* [1911] 1 Ch 425 at 435; *In re Denham* (1884) 25 Ch D 752; *Overend & Gurney Co v Gibb & Darby* (1872) LR5HL 480.

17 [1906] 2 Ch 34.

18 Ibid, at 44 per Cozens-Hardy LJ.

19 See further R Grantham, 'The Doctrinal Basis of the Rights of Company Shareholders' (1998) 57 *Cambridge LJ* 554 at 566.

20 [1935] 2 KB 113; [1935] All ER Rep 456.

> re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders.[21]

This definitive recognition by the judiciary of the board of directors, rather than the general meeting of shareholders, as the pre-eminent organ of corporate decision-making formalised the separation of ownership and control of the modern public company, a development which was discerned and commented upon with compelling force by Berle and Means as noted earlier on.[22] Bainbridge has described this paradigm as the director primacy model of corporate governance.[23] According to the Privy Council, under the regime established by current arrangements, directors, acting within their management powers, may 'take decisions against the wishes of the majority of shareholders, and indeed . . . the majority of shareholders cannot control them in the exercise of these powers while they remain in office'.[24] This puts to rest the view originally espoused by the courts that a majority of shareholders had power in a general meeting to control the acts of the directors.[25] Lynn Stout has crisply described the effects of the separation of ownership and control in these colourful words:

> The investor who uses her hard-earned money to buy shares from a public company firm relinquishes her power to determine how those funds will be used in the future. Her personal assets become corporate assets subject to the directors' control. *It is now the directors, and not the investor, who will decide how the firm shall be run, whom it shall hire, and what it shall invest in. It is also the directors, and not the investor, who will decide whether corporate earnings will be used to pay dividends, or used instead to build empires, raise salaries, and support charities*.[26]

Under current Australian corporate law, members of a company may adopt constitutional provisions that modify the present default rule. They are free,

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21 Ibid, at KB 133 per Greer LJ (Slesser LJ and Roche J concurring). For an erudite summary of the legal effect of these decisions, see Bottomley, above n 6, pp 82–3; Hill, above n 9, at 48–9; B Slutsky, 'The Relationship Between the Board of Directors and the Shareholders in General Meeting' (1967-68) 3 *Uni of British Columbia L Rev* 81 at 81–90. For some Australian cases discussing the effect of this development, see *National Roads & Motorists' Association v Parker* (1986) 6 NSWLR 517; 11 ACLR 1; 4 ACLC 609; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 NSWLR 68; [1974] AC 821; (1974) 3 ALR 448; 48 ALJR 5.

22 See the introduction to this article. See also M J Roe, *Strong Managers, Weak Owners — The Political Roots of American Corporate Finance*, Princeton University Press, Princeton NJ, 1994, pp 3–8.

23 See S M Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance', February 2002, UCLA, School of Law Research Paper No 02-06, at SSRN <http://ssrn.com/abstract=300860> (accessed 3 June 2009). See also Bottomley, above n 6, p 88.

24 *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 837 per Lord Wilberforce; [1974] 1 NSWLR 68; (1974) 3 ALR 448; 48 ALJR 5. See further *Gramophone & Typewriter Ltd v Stanley* [1908] 2 KB 89; [1908-10] All ER Rep 833; Grantham, above n 19, at 556; L Stout, 'The Shareholder as Ulysses: Some Empirical Evidence on Why Investors in Public Corporations Tolerate Board Governance' (2003) 152 *Uni of Pennsylvania L Rev* 667 at 692–3.

25 See *Isle of Wight Railway Company v Tahourdin* (1883) 25 Ch D 320 at 330–1; *Exeter & Crediton Railway v Buller* (1847) 16 LJ Ch 449.

26 Stout, above n 24, at 668 (emphasis supplied).

instead, to implement provisions that would allow them to participate in the making of any business decision or initiate action on certain matters themselves.[27] However, in practice, members of public companies never do so. The consequence is that truly, 'directors are . . . supreme during their time'.[28] In the exercise of their managerial powers they may, according to their judgment, ignore the wishes of members, even if unanimous.[29] This then calls for an examination of the exact role of shareholders in the management of the affairs of the modern Australian public company. That forms the task of the next section of this analysis.

2.2 The role of the general meeting of shareholders

While reposing primary responsibility for the management of the affairs of a company in its board of directors, the law currently in force facilitates shareholder participation in corporate decision-making to some limited extent. This is out of the recognition that there is a need to provide mechanisms for promoting the accountability of directors. Further, the law gives effect to the view generally accepted by the community that as persons affected by decisions relating to the affairs of companies they invest in, shareholders should, to some extent, have a say in the way its affairs are run.[30] Generally, however, shareholders have very limited power to initiate corporate action.[31]

One area of corporate governance in which shareholders are competent to act is the determination of the composition of the board of directors. The Corporations Act reserves to shareholders the power, by ordinary resolution, to elect the directors of a company.[32] Also, for sufficient cause, for example, when the performance of a company falls below expectations, shareholders of a public company may dismiss the directors, again by ordinary resolution. Quite significantly, shareholders may exercise this power, at any time, even for no cause at all. In this connection, it should be noted that the constitution of a public company may not exclude or circumscribe the shareholders' power to remove directors.[33]

Shareholders are granted even more voice in relation to the affairs of listed companies. At each annual general meeting of these companies, shareholders enjoy the right, pursuant to s 250S of the Corporations Act, to ask questions of the directors and make comments on the management of the company. Furthermore, the Act requires every listed company to prepare a remuneration

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27 See Corporations Act s 135(2). See further Bottomley, above n 6, pp 84–6; Bebchuk, above n 8, at 849.

28 See Berle and Means, above n 1, p 139. See also Austin and Ramsay above n 14, para 7.110 (pp 224–5); Grantham, above n 19, at 564–5.

29 Grantham, above n 19, at 566.

30 See further Hill, above n 9, at 53; Bottomley, above n 6, p 13.

31 Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 2.2.

32 Corporations Act s 201G.

33 Corporations Act s 203D(1). On the significance of the shareholders' power to replace directors, see L A Bebchuk, 'The Myth of the Shareholder Franchise' (2007) 93 *Virginia L Rev* 675 at 680–1; Austin et al, *Company Directors: Principles of Law and Corporate Governance*, LexisNexis Butterworths, Sydney, 2004, para 4.8 (p 186); E Boros and J Duns, *Corporate Law*, Oxford University Press, Melbourne, 2007, p 96; Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 2.3.

report[34] and, at its annual general meeting, put to the vote a resolution that that report be adopted.[35] Quite importantly, the chair is required to allow members a reasonable opportunity to comment or ask questions about the remuneration report.[36] While it is the case that a resolution that the remuneration report be or not be adopted is only advisory and does not bind the directors,[37] it is nonetheless apparent that the law attempts to give members some right to express a view on the remuneration of directors. By exposing directors to closer scrutiny and, more importantly, denying them tenure, these measures go a long way in promoting shareholder welfare. By virtue of these rules, directors are only too aware that they are liable to lose their offices and perquisites should shareholders, who wield the power to oust them at any time, find their performance wanting.[38] This is apt to induce them to adopt policies in the interests of shareholders.

Another important aspect of corporate governance in which current law assigns members a significant role is the establishment of the constitutional arrangements under which a company is administered. As a practical matter, the initial constitution of a company is framed by its promoters. However, the Corporations Act endows members with authority to amend that document whenever deemed appropriate.[39] This gives subsequent members an opportunity to determine the governance arrangements that best serve their interests and needs. The exercise of this power is subject only to the limitations that in altering the constitution, members must act in the interest of the company as a whole[40] and not oppressively of the minority.[41]

Furthermore, as a means of protecting the company against overreaching by directors, current law empowers members to veto certain director initiated transactions in which there is potential for self-dealing or conflict between the interest of the company and that of the directors. The special transactions which require shareholder approval before they may be consummated include mergers and reconstructions,[42] certain capital issues,[43] transactions with

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34 Corporations Act s 300A(3).

35 Corporations Act s 250R(2).

36 Corporations Act s 250SA.

37 Corporations Act s 250R(3).

38 See further Easterbrook and Fischel, above n 9, at 408. It is recognised that shareholders face some difficulties which hamper their ability to fully exercise this power and so discipline directors effectively. A full discussion of this issue is beyond the scope of this work. For a good account of this problem and related issues reference may be made to Berle and Means, above n 1, pp 76–83; Bebchuk, above n 8, at 856–7; D R Fischel, 'The Corporate Governance Movement' (1982) 35 *Vanderbilt L Rev* 1259 at 1277.

39 Corporations Act s 136(2).

40 *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656; *Peter's American Delicacy Co v Heath* (1939) 61 CLR 457; [1939] ALR 124; (1939) 12 ALJR 403; BC3900034.

41 *Gambotto v WCP Ltd* (1995) 182 CLR 432; 127 ALR 417; [1995] HCA 12; BC9506434.

42 Corporations Act s 411.

43 ASX Listing Rule 7.1 The listing rules play an important role in the protection of the interests of listed companies. Every listed entity is bound to comply with these rules: ASX Listing Rule 18.6. In the event of non-observance, ASIC, the licencee or any person aggrieved may make an application to the court seeking compliance: Corporations Act s 793C.

specified related persons[44] and significant changes in the activities of a company which involve the disposal of its main undertaking.[45] This veto power operates to protect shareholders by enabling them to prevent transactions which they consider would leave them worse off.[46] Jennifer Hill has characterised shareholder action in this sphere as a form of alternative corporate regulation, ensuring that only disinterested directors participate in decision-making when these matters arise.[47]

Besides the specific grants of authority just outlined, shareholders may exercise any additional powers conferred on them by the company under its constitution.[48] As an example, the constitution of a public company may confer on members the power to approve or decline the registration of a transfer of shares acquired pursuant to a proportional partial takeover offer.[49]

In order to render the rules which grant members rights to have a say in the affairs of a company more effective, the Corporations Act empowers them, provided the appropriate procedure is observed, to cause company meetings to be held in order to consider proposed resolutions.[50] The holding of a company meeting at the behest of members may be achieved in one of two ways. Under s 249D of the Corporations Act, members may requisition a meeting. This power may be exercised either by 100 members entitled to vote at a general meeting of the company or by a member or members holding at least 5% of all voting rights exercisable at the meeting. The directors must convene any meeting requisitioned for a proper purpose[51] and no later than 21 days from the date of receipt of the requisition.[52]

As an alternative to requisitioning a meeting, members may call and arrange the holding of a meeting themselves. Under s 249F(1) of the Corporations Act, this right is exercisable by a member or members holding at least 5% of all voting rights that may be cast at a meeting.[53] Members who convene a meeting must meet the expenses involved. Finally, instead of either requisitioning or convening a meeting, members holding at least 5% of all voting rights that may be cast at a meeting, or at least 100 members who are entitled to vote at a meeting may, if proper prior notice has been given, move a resolution at a meeting convened by the company.[54]

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44 Corporations Act Ch 2E. The Australian Stock Exchange (ASX) imposes a similar requirement. See ASX Listing Rule 10.1.

45 ASX Listing Rule 11.2.

46 Bebchuk, above n 8, at 862.

47 See further Hill, above n 9, at 69–71.

48 Corporations Act s 198A(2). As to current practice regarding the allocation of power between directors and shareholders see discussion accompanying nn 27–28 above and that accompanying nn 148–150 below. On the significance of allocating decision-making power between different organs of a company, see Bottomley, above n 6, pp 67–9.

49 Corporations Act s 648D.

50 See further Hill, above n 9, at 59.

51 *John Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113; [1935] All ER Rep 456; *National Roads & Motorists' Association v Parker* (1986) 6 NSWLR 517; 11 ACLR 1; 4 ACLC 609.

52 Corporations Act s 249D(5).

53 For a more comprehensive analysis of the shareholders' power to call meetings and related issues, see N Pathak and H Lauristen, 'A Shareholder's Right to Call General Meetings — a Sharp Sword for the Disgruntled Shareholder or Just a Blunt Instrument?' (2005) 23 *C&SLJ* 283.

54 Corporations Act s 249N(1).

The rules which confer on shareholders power to cause the holding of company meetings or to put resolutions at such events play an important role in the protection of the interests of a company. They encourage interested members to monitor the stewardship of a company's affairs by the incumbent management team. Where members believe that the performance of their company is below its full potential, which may be so because the directors are either self serving, negligent, incompetent or merely apathetic, they can take remedial action, including removing the directors. To that extent, these rules assist to promote the accountability of directors and, ultimately, enhance shareholder welfare.

It will be seen from this account that current Australian corporate law facilitates some shareholder involvement and voice in the affairs of public companies.[55] But, it is also apparent that members may not readily initiate action by companies[56] or intervene in the day to day conduct of the business affairs of public companies. Further, while the law affords shareholders a say on certain transactions instigated by directors in which there is potential for conflict of interest, the range of matters on which they are entitled to express a view (through either approval or disapproval) is quite narrow. In the main, the responsibility for making routine business decisions is reserved predominantly to the board of directors. The role of shareholders is, for the most part, limited to that of on-going monitors of management performance. As the discussion in the ensuing part will show, this governance model has 'a strong efficiency justification'.[57]

2.3 Managing the modern large public company: Why almost exclusive director control

Today, the separation of ownership and control of large public companies is a common-place phenomenon in Australia. As has just been demonstrated, current Australian corporate law restricts shareholder participation in the management of the business of modern, large Australian public companies. It entrusts that responsibility, instead, to their boards of directors. This legal framework serves some useful corporate purposes.

It is an observed fact that the modern, large Australian public company, like its counterpart in other advanced capitalist economies, typically incorporates institutional and numerous, small and widely dispersed shareholders.[58] This ownership structure creates a few problems. One of these is that it is not feasible for fragmented shareholders, who typically own only small parcels of

55 Hill, above n 9, at 49.

56 See also P Darvas, 'Section 249D and the "Activist" Shareholder: Court Jester or Conscience of the Corporation?' (2002) 20 *C&SLJ* 390 at 392–4; Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 2.6; Bainbridge, above n 23, p 2.

57 S M Bainbridge, 'Director Primacy and Shareholder Disempowerment' (2006) 119 *Harvard L Rev* 1735 at 1751.

58 See, eg, J Farrar, *Corporate Governance, Theories Principles and Practice*, 3rd ed, Oxford University Press, Melbourne, 2008, p 51. On the shareholding patterns of modern large public companies generally, see Berle and Means, above n 1, p 48; Roe, above n 22, p 4; Bebchuk, above n 8, at 848; I Anabtawi, 'Some Skepticism About Increasing Shareholder Power', August 2005, UCLA School of Law, Law-Econ Research Paper No 05-16, at SSRN <http://ssrn.com/abstract=783044>, pp 14–15 (accessed 3 June 2009).

shares, to play a significant role in the management of the companies in which they invest. In order that they may be in a position to engage effectively in matters of corporate governance, shareholders need to devote time and resources to acquaint themselves with the affairs of a company.[59] However, because their interest in a company is often minimal, most small, dispersed shareholders do not have a large enough incentive to devote the resources necessary to acquire and assess the information needed to enable them to participate meaningfully in the management of a company.[60] Since it is not economically worthwhile for them to incur the requisite monitoring costs,[61] they choose, on rational grounds, to be apathetic. Indeed, as Hutchison and Alley have observed, 'intelligent investors have an incentive to let other smart investors bear the expense of collecting good information, which can be costly to obtain'.[62] It thus appears that a legal regime which precludes persons who may not be well informed about the affairs of a company from intervening in its business decision-making processes, and leaving that function exclusively to the board of directors, as does current Australian law, makes eminent sense.[63]

True, in addition to small, dispersed shareholders, the membership of a large public company often includes institutional investors. Because they own sufficiently large blocs of shares, there is potential for these investors to play an important role in matters of corporate governance. They have the resources and technical ability to monitor management performance.[64] Also, in order to safeguard their interest, they often have an incentive to do so.[65] Indeed, according to the Parliamentary Joint Statutory Committee on Corporations

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59 See further Bottomley, above n 6, p 28.

60 Berle and Means, above n 1, pp 44–6; Bainbridge, above n 23, p 31; Harner, above n 9, p 12; Easterbrook and Fischel, above n 9, at 397; H G Hutchison and R S Alley, 'Against Shareholder Participation: a Treatment for McConvill's Psychonomicosis' (2007) 2 *Brooklyn Jnl of Corporate, Financial and Commercial Law* 41 at 45.

61 H G Hutchison and R S Alley, 'The High Costs of Shareholder Participation', March 2008, George Mason Law & Economics Research Paper No 08-18, at SSRN <http://ssrn.com/abstract=1112885>, p 9 (accessed 3 June 2009); S J Grossman and O D Hart, 'Takeover Bids, the Free Rider Problem and the Theory of the Corporation' (1980) 11 *Bell Jnl of Economics* 42 at 42; R C Clark, 'Vote Buying and Corporate control' (1979) 29 *Case Western Reserve L Rev* 776 at 779; Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 3.48.

62 Hutchison and Alley, above n 61, p 9; Easterbrook and Fischel, above n 9, at 403; I Anabtawi and L A Stout, 'Fiduciary Duties for Activist Shareholders' (2008) 60 *Stanford L Rev* 1255 at 1257 and 1275–6; M M Siems, *Convergence in Shareholder Law*, Cambridge University Press, 2008, p 89.

63 On this see further Hutchison and Alley, above n 61, p 6; L A Stout, 'The Mythical Benefits of Shareholder Control' (2007) 93 *Virginia L Rev* 789 at 792; E N Veasey, 'The Stockholder Franchise is not a Myth: a Response to Professor Bebchuk' (2007) 93 *Virginia L Rev* 811 at 817.

64 Harner, above n 9, p 13.

65 J Sher, 'The Changing Role of Institutional Investors in Australia — A Paradigm Shift?' (2007) 21 *Aust Jnl of Corp Law* 81 at 93; Anabtawi and Stout, above n 62, at 1275–6; S Bhagat, B Black and M Blair, 'Relational Investing and Firm Performance' (2004) 27 *Jnl of Financial Research* 1 at 9; J Hill, 'Institutional Investors and Corporate Governance in Australia' in T Baums, R M Buxbaum and K J Hopt (Eds), *Institutional Investors and Corporate Governance*, Walter de Gruyter, Berlin, 1994, p 597; J Mannolini, 'CLERP and Takeover Law Reform — Politics Trumping Principle?' (1999) 10 *Aust Jnl of Corp Law* 193 at 213; Harner, above n 9, pp 13–14.

and Securities, there is some evidence of increasing engagement by institutional investors with corporate management.[66]

However, while they are minded to keep a watchful eye open in order to protect their interest, available studies indicate that, except in a few episodic instances, institutional investors are generally loath to get involved in the operational matters of companies in which they invest.[67] For the most part, they follow the Wall Street Rule. When dissatisfied with management performance, their preferred course of action is usually to simply liquidate their holdings.[68]

The problems just alluded to are quite weighty. But, even if these difficulties could be overcome, it is still arguable that a large public company would still be better off if shareholders generally left the responsibility of making routine business decisions to the board of directors.[69] It is an acknowledged fact that the class of persons who invest in public companies has broadened considerably.[70] It is also beyond doubt that a significant proportion of these investors are not business persons, in the sense of having any special knowledge or skills in the field of business management.[71] Because of this circumstance, most ordinary investors are not in a position to make rational business decisions, for example, those relating to entry into business contracts or the appointment, remuneration and dismissal of employees. Making determinations on these matters requires significant business acumen and intimate knowledge of a company's business. Quite often, most ordinary shareholders lack these attributes.[72]

In any event, many business decisions require quick action. This renders shareholder involvement in such matters inadvisable. In the first place, shareholders' general meetings take place infrequently.[73] Second, even with modern communication technology, shareholder voting is slow and quite expensive. As observed before, a typical large public company ordinarily

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66 Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 3.4; Harner, above n 9, p 15.

67 This phenomenon is very much evident in Australia today, as recent findings on the voting trends of the largest shareholders in Australian companies indicate. On this see, eg, Hill, above n 9, at 75; Mannolini, above n 65, at 197; G P Stapledon, *Institutional Shareholders and Corporate Governance*, Clarendon Press, Oxford, 1996, p 253; F Buffini, 'Institutions Still Loath to Use Voting Power', *The Australian Financial Review*, (Sydney), 11 March 2004, p 5.

68 Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, paras 3.6–3.10; Stapledon, above n 67, pp 128 and 257; Bainbridge, above n 23, p 29; Fischel, above n 37, at 1277–8; F H Easterbrook and D R Fischel, 'The Proper Role of Target Management in Responding to a Tender Offer' (1981) 94 *Harvard L Rev* 1161 at 1171; G R Andre, 'Tender Offers For Corporate Control: A Critical Analysis and Proposals for Reform' (1987) 12 *Delaware Jnl of Corp Law* 865 at 867.

69 M M Blair, 'Why Markets Chose the Corporate Form: Entity Status and the Separation of Asset Ownership From Control', 14 July 2003, Georgetown Law and Economics Research Paper No 429300, at SSRN <http://ssrn.com/abstract=429300>, p 3 (accessed 3 June 2009). See also Easterbrook and Fischel, above n 9, at 403.

70 *Re Marra Developments Ltd* (1976) 1 ACLR 470 at 478–9; (1975-76) CLC 40-259.

71 Ibid.

72 See further Bottomley, above n 6, p 85.

73 Austin and Ramsay, above n 14, para 7.091 (p 223); R R Pennington, *The Investor and the Law*, Macgibbon & Kee, London, 1968, p 415.

incorporates thousands of shareholders.[74] In these circumstances, to facilitate active and effective shareholder participation in decision-making, substantial costs would need to be incurred in establishing mechanisms for determining the wishes of masses of people on the various issues that may fall to be decided from time to time. Economic considerations suggest that it would be imprudent to impose such costs on public companies.[75]

In the result, it appears that it is not only highly desirable but also absolutely essential to entrust the management of the business of a large public company to a small, select group of persons with expertise in managing capital, a body that is knowledgeable about a company's business affairs and one that is capable of acting with timeliness and speed. These are the quintessential characteristics of the board of directors of the modern large public company. It is thus arguable that the legal framework presently governing the management of large public companies is both defensible and advantageous. It offers a set of rules and procedures that provide the most efficient decision-making system in the context of corporate management.[76] By delegating the management function to the board of directors, to the exclusion of shareholders, it solves many of the problems that would arise if shareholders were to intervene in the making of routine business decisions. This promotes efficiency in the management of the affairs of public companies. Another equally desirable advantage offered by the present regime is that it enables people with surplus funds, but who may lack managerial skills, to participate in the gains from entrepreneurial ventures by investing their hard-earned money in companies run by skilled managers. At the same time, it enables people with expertise in business management to organise and run economic ventures even though they lack personal wealth.[77] To the extent it does this, current law serves some highly beneficial social and economic functions. Having regard to these matters, policy makers should be very cautious about fundamentally changing the current legal framework. As the discussion in Part 3.2 will endeavour to show, altering the law to empower shareholders to interfere in operational matters risks destroying quality corporate decision-making and, concomitantly, potentially disrupting the smooth running of public companies. This is bound to undermine, rather than advance, shareholder welfare.[78]

Considerations of shareholder welfare aside, we need to keep in mind the fact that the modern public company plays a critical role in the efficient and

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74 See the discussion accompanying n 57 above.

75 See further S M Bainbridge, 'The Politics of Corporate Governance: Roe's Strong Managers, Weak Owners' (1994-1995) 18 *Harvard Jnl of Law & Public Policy* 671 at 675; Hutchison and Alley, above n 61, p 14; Stout, above n 24, at 693; Stout, above n 62, at 792.

76 Bainbridge, above n 23, pp 6–7; Stout, above n 62, at 791.

77 Stout, above n 62, at 797–8; Siems, above n 62, p 153; Bottomley, above n 6, p 87; Roe, above n 22, p 4–5; Fischel, above n 37, at 1262; Easterbrook and Fischel, above n 9, at 401; Council of Economic Advisers, 'The Market For Corporate Control' in T Calvani and J Siegfried, *Economic Analysis and Antitrust Law*, 2nd ed, Little Brown & Co, Boston, 1988 p 287; A Mandelbaum, 'Economic Aspects of Takeovers Regulation With Particular Reference to New Zealand' in J H Farrar (Ed), *Takeovers, Institutional Investors and the Modernization of Corporate Laws*, Oxford University Press, Auckland, 1993, p 205.

78 For more on this, see T N Mirvis, P K Rowe and W Savitt, 'Bebchuk's Case for Increasing Shareholder Power: An Opposition', May 2007, Power' The Harvard John M Olin

proper functioning of the economic order of society. Indeed, it has been observed that:

> of all the institutions that shape . . . society, none are more dominant than business corporations. They supply most of the food that is eaten, most of the clothes that are worn, most of the shelters that are inhabited, and most of the entertainments that are enjoyed. They are also the largest providers of the wages and the workplaces that determine the quality of a large sector of many people's lives. Corporations' criteria for advancement or demotion rule perceptions of personal success or failure. Corporate dividend and interest payments sustain insurance and annuities and motivate most of the savings that finance capital investment. Corporations deliver most of the revenue of state and federal governments, partly by paying their own taxes and partly by collecting and remitting most of the income, social security, and excise taxes levied against their employees and customers.[79]

Stephen Bottomley has also acknowledged the fundamental role that companies play in the economy, observing that 'corporations accumulate, convert, produce and disperse economic resources'.[80] And another very distinguished corporate law scholar, Bayliss Manning, once described the modern public company as 'the most successful institution yet designed by any society to carry out the vital tasks of capital assembly, resource allocation, production, employment and distribution'.[81] In light of this, it would not be far-fetched to argue that compromising the efficient functioning of Australian public companies, through weakening the processes which promote quality corporate decision-making, carries the risk of harming social welfare too. A more detailed consideration of this issue follows in the next Part.

3 Corporate management: To reverse or not to reverse *Automatic*

3.1 Some recent experiences

In the recent past, some activist shareholders have employed the powers conferred on members in relation to the amendment of a company's constitution and the calling of company meetings to put resolutions at the meetings of various public companies with the aim of compelling the companies involved to adopt measures designed to achieve certain outcomes sought by these member groups.

In October 2003, a group of shareholders put resolutions at the annual general meeting of Boral Ltd aimed at 'improving the transparency,

Discussion Paper Series, Discussion Paper No 586, at SSRN <http://ssrn.com/abstract=990057>, p 7 (accessed 16 May 2009); Fischel, above n 37, at 1276–7.

79 A F Conard, 'Theses for a Corporate Reformation' (1986) 19 *Uni of California Davis LJ* 259 at 260.

80 Bottomley, above n 6, p 111.

81 See Bayliss Manning, letter to New York Stock Exchange, cited in US House of Representatives, Sub-Committee on Telecommunications, Consumer Protection and Finance of The Committee on Energy and Commerce, Corporate Governance, Washington DC, 1987, p 69. See also Rawling, above n 6, at 228; L S Sealy, *Company Law And Commercial Reality*, Sweet & Maxwell, London, 1984, p 1.

accountability and effectiveness of Boral's safety policies'.[82] The resolutions required the company, among other things, to establish structures to ensure that the company fully implemented its safety policies. They also called for the company to amend its constitution to impose a requirement of a board committee responsible for safety and related issues, the appointment of a safety auditor and a further requirement for Boral to adhere to higher safety reporting requirements. As well, a resolution was put to amend the company's constitution so that the company, and not the board, would fix the remuneration of Boral's directors.[83]

In addition to Boral, a number of other companies have also been the subject of spells of shareholder activism. These include Rio Tinto Ltd in 2000, Australia and New Zealand Banking Group Ltd (2003), Commonwealth Bank of Australia Ltd (2003), BlueScope Steel Ltd (2004), Qantas Airways Ltd (2004), National Roads and Motorists' Association Ltd (2004) and James Hardie Industries Ltd (2004).

With the exception of James Hardie Industries Ltd, action was taken in all these instances by trade union shareholder groups after encountering difficulties in their enterprise bargaining negotiations with the subject companies. The object of the various unions' campaigns was, quite patently, to put some pressure on these companies to reach settlements favourable to their members on various industrial relations issues. In the exceptional case of James Hardie Industries Ltd, action was taken by the Australian Congress of Trade Unions and certain other trade unions in an endeavour to compel the company to make adequate provision for the compensation of its former employees who had contracted asbestos related illnesses as a result of their work with that company.[84]

Activist shareholders have not acted solely to promote employee interests. There have also been attempts to advance a plethora of other causes. For example in 1999, the Australian Wilderness Society requisitioned a general meeting of Wesfarmers Ltd at which it put resolutions calling on the company to cause its subsidiary, Bunnings Ltd, to stop logging in the old growth forests of Western Australia.[85] Also, in that same year, some shareholders of North Ltd (North Ethical Shareholders Group) requisitioned a general meeting of the company and proposed resolutions at that meeting requiring it to stop mining uranium in Jabiluka National Park.[86]

Attempts by groups of activist shareholders to dictate corporate policy and direction have been welcomed in some quarters. For example, Rawling has supported actions taken by trade union shareholder activist groups as a legitimate means of promoting worker concerns.[87] This sentiment was prompted, in large measure, by the changes in labour law brought about by

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82 For a fuller discussion of this saga see Rawling, above n 6, at 232.

83 For a more detailed discussion of these resolutions, see Rawling, above n 6, at 229–33; K Anderson and I Ramsay, 'From the Picket Line to the Board Room: Union Shareholder Activism in Australia' (2006) 24 *C&SLJ* 279 at 289–92.

84 For an account of the actions taken in these instances see Rawling, above n 6, at 229–33; Anderson and Ramsay, above n 83, at 284–305.

85 See generally Anderson and Ramsay, above n 83, at 284.

86 Ibid.

87 See generally Rawling, above n 6.

legislation enacted by the then government which had the effect of significantly diminishing the ability of employees and trade unions to advocate their interests.[88]

In similar vein, some scholars have recommended the adoption of measures that would authorise members to pass binding resolutions instructing corporate management to take specific actions or to enter into particular transactions. Under these proposals, shareholders could, for example, order corporate management to pay a dividend at a particular rate at a certain date,[89] sell off or distribute a company's assets, accept certain merger or takeover proposals or even seek the dissolution of a company.[90]

The proposal to empower shareholders to dictate corporate action is made on the premise that regular shareholder intervention in corporate management is essential in order to reduce the agency costs that exist in public companies. It is contended that because there is a range of cases in which the interests of shareholders and management diverge, there is a possibility that, for self-serving purposes, directors could, in some instances, refuse to enter into certain transactions even if pursuing them would serve the interests of shareholders. Conversely, it is argued that there is potential for directors to take certain actions destructive of shareholder value out of self-interest or for other irrelevant purposes. It is postulated that the prospect of shareholder intervention would largely overcome these problems.[91]

The bid to render shareholder intervention in corporate decision-making more common place has the potential to nullify the efficiency gains promoted by the legal framework which currently governs the decision-making processes of large public companies.[92] This is likely to present a serious threat to overall shareholder welfare, especially since institutional and activist shareholder groups are often inclined to promote sectional interests as the discussion above has demonstrated. The next section takes a closer look at the problems likely to be engendered by increased shareholder intervention in corporate management.

3.2 The potential costs of shareholder intervention in routine business decision-making

If adopted, the proposals for shareholders to more readily intervene in the day to day operations of public companies, will certainly change the presently acknowledged roles of shareholders and directors quite considerably. Very significantly, they will weaken the current legal framework which precludes shareholders from participating in the making of routine business decisions,[93] a model of corporate decision-making that has been characterised as being 'well-suited to the problem of operating a large enterprise with numerous

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88 See Workplace Relations Amendment (Work Choices) Act 2005 (Cth); Workplace Relations Act 1996 (Cth). These laws have now been largely neutralised by the current Labor Government through the passage of the Fair Work Act 2009 (Cth).

89 Bebchuk, above n 8, at 901.

90 Ibid, at 902.

91 Ibid, at 896–903.

92 See the discussion in Part 2.1–2.2 above.

93 See discussion in Part 2 above. See also M Lipton and W Savitt, 'The Many Myths of Lucian Bebchuk' (2007) 93 *Virginia L Rev* 733 at 733.

employees, managers, shareholders, creditors and other inputs'.[94] Given the important role that the current model plays in promoting the efficient functioning of the modern public company,[95] the proposals to increase shareholder power in the manner outlined have the potential to produce a negative impact on the governance of Australian public companies. As Bebchuk has observed, 'the quality of governance arrangements affects firm performance and shareholder value'.[96]

Underlying the call to give shareholders power to intervene more frequently in the management of the affairs of public companies is the assumption that all shareholders have interests that are 'fundamentally in harmony with one another'[97] and so 'have a common interest in improving corporate performance'.[98] However, 'while neoclassical economics assumes that shareholders come to the corporation with wealth maximisation as their goal and most presumably do so'[99] it is also a fact that shareholder interests are highly fragmented.[100] Shareholders are a heterogeneous bunch.[101] There are short-term and long-term shareholders. Some shareholders own diversified portfolios, others do not. Sometimes, companies have hedged and unhedged shareholders. Further, while many shareholders invest in companies for purely economic reasons, there are some members of the public who do so for social and other objectives.[102] Because shareholders are plagued by divergent interests and goals, 'they have different time horizons, risk strategies, tax brackets, dividend preferences, cash preferences and enthusiasm for new projects'.[103] Different groups of shareholders are thus likely to have disparate views of what strategies should be adopted by a company in order to maximise shareholder value. Anabtawi has illustrated this conundrum thus:

> Pitted against shareholders' interest in enhancing share value are significant private interests. Take, for example, a hedge fund shareholder that is about to raise capital for a new fund. As part of its marketing effort, it wants to show impressive returns on its prior fund. To generate such returns, the hedge fund is likely to favour policies by the firms in which it invests that produce short-term gains, even if a more patient investment orientation would generate higher longer-term returns. In contrast, a pension fund or life insurance company shareholder is more likely to be concerned about the long-term value of its investments, which will allow it to meet its future obligations.[104]

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94 Bainbridge, above n 23, p 33. See also Bainbridge, above n 74, at 675; Stout, above n 24, at 685–6.

95 See Part 2.3 above; Bainbridge, above n 23, p 33.

96 Bebchuk, above n 8, at 850.

97 On this see further Anabtawi, above n 57, pp 21–37.

98 Anabtawi and Stout, above n 62, at 1261; Berle and Means, above n 1, p 113.

99 Bainbridge, above n 23, p 14. See also Clark, above n 61, at 793.

100 See further Hutchison and Alley, above n 60, at 57–9.

101 See, eg, J H Farrar, *Corporate Governance in Australia and New Zealand*, Oxford University Press, Melbourne, 2001, p 319; Bottomley, above n 6, p 107.

102 Anabtawi, above n 57, pp 32–3; Hutchison and Alley, above n 61, p 15.

103 Hutchison and Alley, above n 61, p 27; Siems, above n 62, pp 64–5.

104 Anabtawi, above n 57, p 4. See also Anabtawi and Stout, above n 62, at 1258–9 and 1283–92 for more examples of this problem. See further Bottomley, above n 6, p 107; Lipton and Savitt, above n 93, at 745–6; J C Coffee, 'Liquidity Versus Control: The Institutional Investor as Corporate Monitor' (1991) *Columbia L Rev* 1277 at 1334.

As the Cadbury Committee observed, the way in which shareholders use their power is of fundamental importance.[105] In this connection it is worth recalling that because of the rational apathy problem, most small, dispersed shareholders are passive investors.[106] Thus, increasing shareholder power will, in effect, mean augmenting the power of those shareholders who are in a position to actively participate in corporate management. This is most likely to be large institutional investors whose ownership of substantial parcels of shares renders this worthwhile, or activist pension funds and shareholder groups that may have other incentives to do so.

It has been noted by the Business Council of Australia that, currently, special interest groups are dominating company meetings.[107] Given shareholders' divergent interests, there is a danger that these shareholders may use any additional powers they may gain if the proposals to empower shareholders to dictate corporate action are implemented to pursue their private interests, rather than the welfare of shareholders generally.[108] No one can doubt that actions taken by shareholders out of self-interest have the potential to harm fellow shareholders and the company generally.[109]

Shareholders exercise their power by voting at company meetings. In this regard, it needs to be remembered that in voting, shareholders exercise rights of property. Also not to be forgotten is the fact that shareholders are not trustees for one another and, unlike directors, occupy no fiduciary position and are under no fiduciary duties.[110] So they are free to cast their votes for their personal advantage. As Jessel MR boldly proclaimed more than 100 years ago:

> Where men exercise their rights of property, they exercise their rights from some motive adequate or inadequate, and I have always considered the law to be that those who have the rights of property are entitled to exercise them, whatever their motives may be for such exercise — that is as regards a Court of Law as distinguished from a court of morality or conscience, if such a court exists . . . a man may be actuated in giving his vote by interests entirely adverse to the interests of the company as a whole. *He may think it more for his particular interest that a certain course may be taken which may be in the opinion of others very adverse to the interests of the company as a whole, but he cannot be restrained from giving his vote in what way he pleases because he is influenced by that motive. There is . . . no obligation on a shareholder of a company to give his vote merely with a view to what other persons*

105 Sir Adrian Cadbury, *The Financial Aspects of Corporate Governance*, Gee & Co Ltd, London, 1992, para 6.10, at <http://www.ecgi.org/codes/documents/cadbury.pdf> (accessed 4 June 2009).
106 See the discussion in Part 2.3 above.
107 See Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 3.69.
108 See further Hill, above n 9, at 64; Bottomley, above n 6, p 106.
109 See further Sher, above n 64, at 5; Hill, above n 9, at 78; Fischel, above n 37, at 1279.
110 *Peters' American Delicacy Co v Heath* (1939) 61 CLR 457 at 504; [1939] ALR 124; (1939) 12 ALJR 403; BC3900034; See also *North-West Transportation Co Ltd & Beatty v Beatty* (1887) 12 App Cas 589; *Ngurli Ltd v McCann* (1953) 90 CLR 425 at 447; 27 ALJR 349; BC5300930; *Abraham v Tunalex Pty Ltd* (1987) 5 ACLC 888 at 890 where this philosophy was embraced with enthusiasm. See further J H Farrar, 'The Duties of Controlling Shareholders' in J H Farrar (Ed), *Contemporary Issues in Company Law*, Commerce Clearing House (New Zeland), Auckland, 1987, pp 188–9.

> *may consider the interests of the company at large. He has a right, if he thinks fit, to give his vote from motives or promptings of what he considers his own individual interest.*[111]

The dangers inherent in this scenario are self-evident. Truly, as one commentator has rightly observed, 'if management cedes to the demands of the controlling stakeholder, regardless of whether those demands further the interests of the corporation, control of the corporation may benefit one stakeholder or a small group of stakeholders at the expense of others'.[112] This problem becomes more acute when one considers that in a large public company with a widely dispersed shareholding, effective control can be exercised by an investor owning less than a majority of shares issued in its capital.[113]

Granted, in some circumstances some limitations are placed on the voting rights of shareholders. While recognising that shareholders are not trustees for one another, the law requires those shareholders who are in a position to control the affairs of a company to exercise their powers in a fair, just and equitable manner and to pay due regard to the interests of the company and the minority.[114] Thus, members with sufficient votes to carry resolutions at general meetings, whether because of their ownership of substantial shareholdings or because of their control over the proxy system, or both,[115] may not use their voting power to commit a fraud on the company.[116]

While this may be so, it appears that the 'fraud on the power'[117] limitation is not effective to protect all shareholders in circumstances such as those under consideration here. Quite often, activist shareholders do not command a majority of the votes at company meetings. Yet, on the authorities available, it is clear that as currently applied, the fraud on the power doctrine places limitations on the voting powers only of those shareholders in a position to command a majority. Even then, it is apparent that the law precludes them from exercising their voting power only if that is likely to result in the appropriation to themselves of the assets, interests or opportunities of the

111 *Pender v Lushington* (1877) 6 Ch D 70 at 75–6 (emphasis supplied). See also *Peters' American Delicacy Co v Heath* (1939) 61 CLR 457 at 479; [1939] ALR 124; (1939) 12 ALJR 403; BC3900034 per Latham CJ. For some interesting literature on the subject, see Austin and Ramsay, above n 14, para 11.040 (pp 644–5); J H Farrar and B M Hannigan, *Farrar's Company Law*, 4th ed, Butterworths, London, 1998, pp 569–70; L S Sealy, 'Equitable and Other Fetters on the Shareholder's Right to Vote' in B Eastham and N E Krivy (Eds), *The Cambridge Lectures*, Butterworths, Toronto, 1982, p 80.

112 Harner, above n 9, p 17.

113 On this see further Farrar, above n 58, at 47; Berle and Means, above n 1, pp 75–8; M A Weinberg and M V Blank, *Takeovers And Mergers*, 5th ed, Sweet & Maxwell, London, 1989, para 2-203.

114 *Glavanics v Brunninghausen* (1996) 19 ACSR 204; 14 ACLC 345; BC9600179; Austin and Ramsay above n 14, para 11.030 (p 643).

115 *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1981] Ch 257 at 325–6.

116 *Cook v Deeks* [1916] 1 AC 554; [1916-17] All ER Rep 285; (1916) 27 DLR 1; 85 LJPC 161; *Peters' American Delicacy Co v Heath* (1939) 61 CLR 457; [1939] ALR 124; (1939) 12 ALJR 403; BC3900034; *Ngurli Ltd v McCann* (1954) 90 CLR 425; 27 ALJR 349; BC5300930. See also the discussion by Grantham, above n 19, at 573–5.

117 Or 'fraud on the company' as it is interchangeably referred to at times. On this see K W Wedderburn, 'Shareholders Rights and the Rule in Foss v Harbottle' [1958] *Cambridge LJ* 93 at 93–4.

company, or the rights and property of the minority. This much can be extrapolated from the leading case of *Cook v Deeks*.[118] There, the majority were prevented from exercising their votes because they were attempting to use their power to ratify a breach of duty which would have resulted in diverting to themselves the benefits of a contract which they had negotiated on behalf of the company. The Privy Council held that the courts could not sanction such use of power as that 'would amount to forfeiting the interest and property of the minority shareholders in favour of the majority and that by the votes of those holders who are interested in securing the property for themselves'.[119] Given the limited controls on shareholder voting, it should be apparent that increased shareholder involvement in the routine business operations of public companies can be a danger to overall shareholder welfare.

Corporate law seeks to serve the interests of the company as a whole.[120] This means either the general body of shareholders[121] or the company as a separate legal and economic entity.[122] More generally, the law strives to

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118 [1916] 1 AC 554; [1916-17] All ER Rep 285; (1916) 27 DLR 1; 85 LJPC 161.

119 Ibid, at AC 564 per Lord Buckmaster LC. See also *Ngurli Ltd v McCann* (1954) 90 CLR 425 at 440; 27 ALJR 349; BC5300930; *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 All ER 437 at 447; [1982] 1 WLR 2; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134; [1942] 1 All ER 378; *Greenhalgh v Arderne Cinemas Ltd Ltd* [1951] Ch 286; [1950] 2 All ER 1120; *Brown v British Abrasive Wheel Co Ltd* [1919] 1 Ch 290; [1918-19] All ER Rep 308; *Burland v Earle* [1902] AC 83 at 93; [1900-3] All ER Rep 1452; *Menier v Hooper's Telegraph Works* (1874) LR9ChApp 350, 286; (1874) 43 LJ Ch 330; 30 LT 209; 22 WR 396 all of which turned on attempts by the majority to appropriate to themselves advantages of the company or the minority respectively. See further Farrar and Hannigan, above n 111, pp 436–7; Sealy, above n 111, p 80.

120 See Corporations Act s 181(1); *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656; *Ngurli Ltd v McCann* (1954) 90 CLR 425 at 438; 27 ALJR 349; BC5300930; *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199 at 217; 30 ALR 53; BC2300005; *In re Smith & Fawcett Ltd* [1942] Ch 304 at 306; [1942] 1 All ER 542; *Pergamon Press Ltd v Maxwell* [1970] 2 All ER 809 at 813; [1970] 1 WLR 1167.

121 On this refer to the cases cited above n 120. See further Austin and Ramsay, above n 14, paras 8.090–8.095 (pp 356–7); Bottomley, above n 6, p 70; J D Heydon, 'Directors' Duties and the Company's Interests' in P D Finn (Ed), *Equity and Commercial Relationships*, The Law Book Company Ltd, Sydney, 1987, pp 120–6; D G Smith, 'The Dystopian Potential of Corporate Law', March 2007, University of Wisconsin Legal Studies Research Paper No 1040, at SSRN <http://ssrn.com/abstract=976742>, p 12 (accessed 15 May 2009).

122 *Darvall v North Sydney Brick & Tile Co Ltd* (1989) 16 NSWLR 260; 15 ACLR 230; 7 ACLC 659; *Ngurli Ltd v McCann* (1954) 90 CLR 425 at 438; 27 ALJR 349; BC5300930; *Mills v Mills* (1938) 60 CLR 150 at 186; 11 ALJR 527; *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483; 42 ALJR 123; BC6800800; *Australian Metropolitan Life Assurance Co Ltd v Ure* (1923) 33 CLR 199; 30 ALR 53; BC2300005; *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656; *Sidebottom v Kershaw Leese & Co Ltd* [1920] 1 Ch 154; *Dafen Tinplate Company Ltd v Llanelly Steel Company (1907) Ltd* [1920] 2 Ch 124; *Shuttleworth v Cox Brothers & Company (Maidenhead) Ltd* [1927] 2 KB 9; *Dawson International plc v Coats Patons plc* [1989] BCLC 233. For some useful literature on this topic, see B H McPherson, 'Duties of Directors and the Powers of Shareholders' (1977) 51 *ALJ* 460 at 468; G F K Santow, 'Defensive Measures Against Company Take-overs' (1979) 53 *ALJ* 374; Heydon, above n 121, p 122.

On the possible different meanings of the term 'company', see Austin and Ramsay, above n 14, paras 8.090–8.095 (pp 356–7); Farrar and Hannigan, above n 111, pp 570–1; Heydon, above n 121, pp 120–6; F G Rixon, 'Competing Interests and Conflicting Principles: An Examination of the Power of Alteration of Articles of Association' (1986) 49 *Modern L Rev* 446 at 448.

protect the economic order of society.[123] Empowering some shareholders to dictate to directors has the potential to undermine these objectives.[124] Because all shareholders do not have identical interests and information, it is probable that shareholders who are in a position to exercise sufficient influence will not always select the course of action preferred by all shareholders.[125] There is a real danger that activist shareholders might use any enhanced powers gained by them 'in opportunistic and self-serving ways'[126] — to secure private benefits for themselves at the expense of other shareholders[127] or the separate economic entity. 'Whenever shareholders can earn greater returns from advancing their private interests than it costs them as shareholders to do so, they will derive net benefits from using their shareholder power opportunistically.'[128]

To complicate matters further, as the account in Part 3.2 of this article demonstrates, in pursuing their influence as members, some shareholders, for example, environmental protection or trade union groups, may have incentives to promote objectives apart from shareholder welfare maximisation.[129] Indeed, Australian experience to date bears this out. Most cases of shareholder activism so far have involved the pursuit of narrow, particular group interests as opposed to the interests of all shareholders.[130] If these trends continue, it is predictable that unfortunate disputes will likely arise quite frequently among different shareholder groups. Undeniably, as Jennifer Hill has warned 'the greater the role given to shareholders in corporate decision-making, the more likely it will be that doctrines such as oppression, traditionally confined to the close corporation context, will appear in the arena of public corporations where majority and minority interests are in conflict'.[131]

The problem of divergent interests aside, there is the added difficulty that shareholders have distinctly different levels of information.[132] In the result, they are bound to have different opinions about which course of action is likely to maximise the value of the company.[133] Worse still, given the complexity, diversity and sheer scale of modern publicly listed companies,[134] activist shareholders may not have the skills to second guess management.[135] These problems could seriously destabilise and, in the extreme, even wreck companies. So, instead of acting as an instrument of shareholder and social

123 Australian Securities and Investments Commission Act 2001 (Cth) s 1(2)(a).
124 For more on this see Bainbridge, above n 23, p 33.
125 Ibid, at 14; Farrar, above n 101, at 319; Bottomley, above n 6, p 107.
126 Anabtawi and Stout, above n 62, at 1261; Stout, above n 62, at 794–5.
127 Sher, above n 64, at 97; Hutchison and Alley, above n 61, p 13; Hutchison and Alley, above n 60, at 57; Anabtawi and Stout, above n 62, at 1258–60; Stout, above n 62, at 805; Lipton and Savitt, above n 83, at 744–5.
128 Anabtawi, above n 57, p 38.
129 Sher, above n 64, at 32–3; Anabtawi, above n 57, pp 32–4; Bainbridge, above n 23, p 31; Mirvis, Rowe and Savitt, above n 77, at 7; Lipton and Savitt, above n 83, at 744; Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 3.85.
130 See discussion in Part 3.1 above.
131 Hill, above n 9, at 78.
132 See further Bainbridge, above n 23, p 14; Hutchison and Alley, above n 61, p 15.
133 Ibid.
134 Darvas, above n 55, at 394.
135 Sher, above n 64, at 93; Stout, above n 24, at 693; Bainbridge, above n 23, p 15.

welfare maximisation, investing some shareholders with power to dictate corporate policy, through the power to compel directors to take specific actions seems likely to disrupt the efficient and effective operation of public companies. It follows from this that there is a need to check this potential danger. To achieve this, the law should ensure that there is in place a decision-making process capable of advancing the interests of all shareholder groups. As Hill has aptly pointed out, organisations, such as companies, which have multiple constituencies must create unified goals among people with diversified and conflicting interests.[136]

Assigning the responsibility of making routine business decisions to the board of directors can successfully achieve this objective. Directors can reconcile the competing interests of disparate shareholders and other stakeholders implicated in the operations of a public company. In the exercise of their powers and discharge of their duties, directors are subject to fiduciary duties. Of particular significance, these obligations require them to act in good faith and solely for the benefit of the company as a whole.[137] In the discharge of their duties, they may not seek to promote their own interest[138] or that of any other party.[139] 'It is the fundamental duty of directors to make non-sectional decisions.'[140] Another good reason for continuing to entrust the responsibility of making regular business decisions to directors is that, more often than not, they are likely to be more familiar with and knowledgeable about the business of a company than shareholders.[141]

Therefore, in order to protect the interests of all shareholders more fully, the law should endeavour to guard against undue encroachment upon the powers and authority of directors.[142] So, calls to give shareholders power to review management decisions and direct company controllers to initiate or enter into certain transactions favourable to them should be treated with caution.[143] As the Jenkins Committee rightly observed way back in 1962, 'if directors are to manage their company effectively, they must, within broad limits, have a free hand to do what they consider best in the interests of the company'.[144]

It is accepted, as some scholars have argued, that the perception of

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136 Hill, above n 9, at 55. Other constituencies that are sometimes mentioned as being worthy of consideration by directors include employees, customers, dealers, suppliers and the community at large. On this see further Lord Wedderburn of Charlton, 'The Legal Development of Corporate Responsibility: For Whom Will Corporate Managers Be Trustees? in K J Hopt and G Teubner (Eds), *Corporate Governance and Directors' Liabilities: Legal, Economic and Sociological Analyses on Corporate Social Responsibility*, Walter de Gruyter, Berlin; New York, 1985, p 7.

137 See Corporations Act s 181(1). See further the cases cited above n 119.

138 *Ngurli Ltd v McCann* (1954) 90 CLR 425 at 440; 27 ALJR 349; BC5300930.

139 *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 1 NSWLR 68; [1974] AC 821; (1974) 3 ALR 448; 48 ALJR 5; *Re W & M Roith Ltd* [1967] 1 All ER 427; [1967] 1 WLR 432; *Furs Ltd v Tomkies* (1936) 54 CLR 583; 9 ALJR 419; BC3600050.

140 Bottomley, above n 6, p 70.

141 See further Stout, above n 24, at 693. See also discussion accompanying nn 58–72 above.

142 See also Bottomley, above n 6, p 71.

143 See also L E Mitchell, 'The Legitimate Rights of Public Shareholders', GWU Legal Studies Research Paper No 461, at SSRN <http://ssrn.com/abstract=1352025>, pp 34–5 (accessed 15 June 2009).

144 Board of Trade, *Report of the Company Law Committee*, 1962, Cmnd 1749, Jenkins Committee, para 109.

shareholders as members suggests that they are entitled to at least some level of meaningful participation in matters of corporate governance.[145] Further, it is recognised that there is potential for the interests of directors to diverge from those of the company.[146] 'Because managers cannot capture all of the gains if they are successful, and will not suffer all of the losses should the venture flop, they have less incentive to maximize wealth than if they themselves were the principals.'[147] In light of this, it is desirable that our system of corporate law provides effective mechanisms for facilitating shareholder oversight over management. This is essential in order to promote accountability and so protect shareholders against the improper exercise of power by directors.[148]

But, to promote the interests of the company to the fullest extent possible, the law should continue to circumscribe the ability of shareholders to intervene in routine operations of public companies. The shareholders' proper role in the governance of large public companies should primarily be that of scrutinising the conduct of corporate management and taking appropriate remedial action in cases of poor performance, as opposed to, in effect, attempting to run the corporate enterprise on a daily basis. This will help ensure that no particular group of shareholders, who in any event may not have the specific knowledge needed to make decisions concerning the day to day management of a company, can exercise too much control over decisions that affect other shareholders.[149] This should be left to the directors who are likely to have that knowledge and expertise and who are legally bound to advance the interests of all shareholders.

Indeed, anecdotal evidence suggests that this is the course preferred by investors. As observed before, currently promoters have the option to adopt constitutional provisions empowering shareholders to instruct directors to take the types of actions proposed by proponents of shareholder empowerment. It has also been noted that while this may be so, members of public companies ordinarily desist from doing so.[150] Instead, more often than not, the provisions implemented in this regard are those that strengthen director power over shareholders. One can only surmise from this that, essentially, promoters understand that they will be better off if they agree to give up decision-making authority over routine business matters and instead, vest that responsibility in the board of directors. In other words, 'they trust the expertise of professional managers'.[151] This governance structure has the distinct advantage, as Stout has rightly observed, that it 'promotes efficient and informed decision-making, discourages intershareholder opportunism, and encourages valuable specific investment in corporate team production'.[152]

145 Hill, above n 9, at 54; Bottomley, above n 6, p 13.
146 See Berle and Means, above n 1, p 7; Bottomley, above n 6, p 27; Bebchuk, above n 8, at 850.
147 Fischel, above n 37, at 1262.
148 See, further, Conroy, above n 6; Bottomley, above n 6, pp 56, 70.
149 Blair, above n 67, at 16–17. See also Hutchison and Alley, above n 61, p 15; Stout, above n 62, at 794–5.
150 See discussion accompanying nn 27–28 above.
151 Fischel, above n 37, at 1276.
152 Stout, above n 63, at 791.

The Parliamentary Joint Statutory Committee on Corporations and Securities has recently concluded an inquiry into the engagement and participation of shareholders in the corporate governance of Australian companies. It is instructive to note that in its report, *Better Shareholders — Better Company: Shareholder Engagement and Participation in Australia*, the committee did not recommend the introduction of any measure designed to empower shareholders to intervene directly in operational matters. Instead, the committee endorsed the current model of corporate governance. According to the committee, the present legal framework 'recognises that management by shareholders would be impractical, but ensures that those responsible for the company's performance and direction are accountable to the owners of the company for the decisions they make on their behalf'.[153] More telling is the fact that although the committee received several submissions and interviewed a number of people in the course of its inquiry, none of these suggested that it was desirable to encourage shareholders to interfere with the power now bestowed exclusively on directors to decide on business operational matters.

4 Conclusion

The separation of ownership and control of public companies promotes substantial efficiency benefits. This justifies a regime of limited shareholder involvement in routine business decision-making. Because different groups of shareholders have divergent interests, they can be expected to pursue conflicting agendas in the corporate arena. This problem is overcome when decision-making authority with respect to the routine operations of a large public company is removed from shareholders and committed to a board of directors answerable to, and bound to act in the interests of, all shareholders. Empowering shareholders to intervene in ordinary business decisions or dictate corporate policy is bound to destroy the efficient separation of ownership and control promoted by current law. This is likely to impose more costs than benefits on investors and society generally. Therefore, policy makers should treat with caution calls to empower shareholders to intervene routinely in the business operations of public companies. Instead, as a means of promoting shareholder and social welfare more fully, it would be preferable if policy makers implemented measures calculated to improve the ability of shareholders to monitor effectively the performance of corporate management teams, promote robust enforcement of directors' fiduciary obligations and facilitate the timely removal of incompetent or self-serving management.

153 Parliamentary Joint Statutory Committee on Corporations and Securities, above n 12, para 2.3.